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SUBJECT: YANUKOVYCH CONFIDANT AZAROV PROMISES NEW COALITION
AND ECONOMIC REFORM

REF: 2009 KYIV 2124

Classified By: Ambassador John F. Tefft for Reasons 1.4 (b) and (d)

11. (C) Summary. Yanukovych confidant and close economic advisor Mykola Azarov predicted that the President-elect would be in a stronger position to negotiate a new governing parliamentary coalition after the February 25 inauguration. Yanukovych was determined to build a stable coalition to enable budgetary and economic reforms that would bring Ukraine out of economic crisis. Azarov was adamant that Yanukovych would work to avoid early parliamentary elections, as another four months of campaigning would cause the economy to fully collapse. On economic reform, Yanukovych would prioritize budgetary reform, including renegotiating gas prices with Russia. Reduced expenditures in some areas would allow Yanukovych to raise wages and pensions as required by the social spending law passed late in 2009 and to bring the IMF back to Ukraine. Further reform geared at improving the business climate would follow. In addition, the Ambassador stressed the importance of removing highly-enriched uranium (HEU) from Ukraine to eliminate any possibility of terrorist access to the material. End Summary

Inauguration: Confident That It Will Be February 25

12. (C) Yanukovych campaign chairman, Rada Finance and Banking Committee chairman, and former Deputy Prime Minister, Minister of Finance, and State Tax Administrator, Mykola Azarov, told the Ambassador on February 16 that President-elect Yanukovych was as confident as one can be in Ukraine that the inauguration would be February 25. This would allow the courts time to review and issue decisions on any fraud cases filed by Yanukovych's opponent, Yulia Tymoshenko. Yanukovych wanted the inauguration on February 25, although by law he had 30 days from the February 14 Central Election Commission decision on the election, so that he could begin much needed reforms. Azarov said it was important to start reform as soon as possible given the serious economic and social situation in the country. Azarov estimated that the economy had already declined 37% since 2007 and continued on a downward trend.

Expect a New Parliamentary Coalition After the Inauguration

13. (C) Azarov said that it was far more difficult to form a new parliamentary coalition than to overcome accusations of falsifications in the election. Nonetheless, Yanukovych and his Party of Regions would expend every effort to form a new

coalition and avoid early parliamentary elections. Azarov predicted that Yanukovych would be in a stronger position to negotiate after the inauguration and that a new coalition would come together within a week after the inauguration. Yanukovych would need the Our Ukraine-People's Self Defense (OU-PSD) faction in the parliament to be able to form a new coalition; however, Azarov complained of the difficulty of negotiating with the various components of OU-PSD. Yanukovych's condition for new coalition partners would be that the coalition should remain stable for at least two years. If others could not agree to maintain a coalition for 2 years, Azarov predicted Yanukovych would want new parliamentary elections. Azarov said that another four months in campaign mode would cause the economy to fully collapse, however, and should be avoided.

Prime Minister Azarov? Maybe Not

¶4. (C) Responding to the Ambassador's question about where Azarov would end up in the new government, Azarov said we should talk directly with Yanukovych. (Comment: Although Azarov in the past has openly said he hoped to be the next Prime Minister, his chances appear to be dropping. Azarov admitted that negotiations to bring OU-PSD into the coalition have been difficult. Yanukovych may need to offer the position to others to bring them in. End Comment.)

President's Phone Call/ HEU/ Nuclear Energy

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¶5. (C) The Ambassador noted that the February 11 congratulatory phone call between President Obama and Yanukovych had gone well and could be considered a good first step to establishing a positive relationship between the two leaders. In particular, the Ambassador highlighted the importance of Ukraine making a decision on the issue of eliminating stored HEU before Yanukovych traveled to Washington for the nuclear security summit in April. Nuclear security was a priority for President Obama. In response, Azarov said that Yanukovych was grateful for the President's phone call, which Yanukovych had taken as moral support. Azarov said that he was well aware of the HEU problem; however, he turned the conversation to issues related to Ukraine's civil nuclear power generation. Azarov said that Ukraine possessed natural uranium deposits that it hoped to use, including in its own nuclear energy reactors. He emphasized the need to modernize Ukraine's old nuclear energy plants and build new reactors. Azarov promised that the new team expected to work with the United States as a partner in this modernization. The Ambassador assured Azarov that the United States and Westinghouse stood ready to work closely with Ukraine to help it modernize, expand, and diversify its nuclear energy sector. The Ambassador underscored that on the separate issue of HEU we also needed to work together to remove and safeguard stockpiles to prevent any possibility of terrorist access to the material.

Economic Reform Cannot Wait

¶6. (C) Azarov stressed that Yanukovych would quickly start to work on reform that would bring economic growth back to Ukraine. Azarov was critical of Prime Minister Tymoshenko's management of the economy and said Yanukovych and his team were taking over at one of the most difficult times in the economic history of Ukraine. The government is broke; economic decline continues; lack of reform in the agricultural sector has left farmers to face higher prices for inputs without access to credit; and gas payments to Russia would continue to be a drain on the economy. Reform

under these conditions would be painful, but necessary, according to Azarov.

17. (C) As a first priority, Yanukovych would implement budgetary reform. Budgetary savings in some areas would allow the Party of Regions to raise wages and pensions as required by the social spending law passed late in 2009. Azarov estimated that UAH 1.8 billion (\$225 million) per month was needed to fund the social spending law. He pointed out that Tymoshenko had unjustly spent UAH 5.5 billion in the last throes of the presidential campaign to issue land titles to the public. While the Party of Regions wanted to systemically address land reform issues, Azarov said that Yanukovych would end this land titling program, reducing government expenditures. Azarov believes there are many more programs like this that could be slashed. Azarov reiterated that Yanukovych would seek to renegotiate gas prices with Russia to help reduce the burden on the Treasury. Azarov expected that budgetary reform would be carried out over the next two years. As a second step, the new President would address issues that improve the business climate to attract investment; these would include deregulation, tax reform, energy efficiency, and ending the moratorium on agricultural land sales.

18. (C) Ambassador Tefft mentioned that the business community had impressed upon him, as they have on each of his predecessors, the importance of establishing a predictable mechanism for value-added tax (VAT) refunds. Displaying familiarity with the issue -- Azarov had been instrumental in establishing the current system -- Azarov said he was conducting meetings with the local Ukrainian business community to consider VAT reform. Azarov noted that VAT claims in 2009 had more than doubled over claims in 2008 and accused the Tymoshenko government of corruption in the system. He agreed to meet with U.S. and other foreign stakeholders to discuss reform. Azarov also stressed that Yanukovych would tackle corruption in Ukraine to attract investment.

19. (C) Azarov said that Yanukovych and his government would

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be ready to work with the IMF to bring stability back to the country so that investors would return. He criticized Tymoshenko for wasting the \$10.6 billion and the extra \$2 billion in Special Drawing Rights received from the IMF over the past year. Azarov, who has extensive experience dealing with the IMF, hoped to negotiate to ensure a good package for Ukraine.

Comment

19. (C) Azarov is intimately familiar with Ukraine's economic problems and continues to make notably orthodox arguments promoting economic reform. Although it is too early to know whether Yanukovych and his new team will be able to deliver on their promises to bring the budget under control and make changes that will attract business, their pragmatic plans for reform are encouraging. Much will depend on Yanukovych's ability to build a strong and stable coalition within the parliament. As we have seen over the past year, the President and the Prime Minister need to work together or progress will continue to be stymied.

TEFFT